Asia Credit Research

OCBC Bank

First REIT: Credit Update

Wednesday, 27 July 2016

The Triumvirate Continues

- **Healthy results in 1H2016:** FREIT reported an increase in gross revenue by 6.8% to SGD53.1mn against 1H2015. Taking out the effects from Siloam Hospitals Kupang and Lippo Plaza Kupang (acquired in December 2015), we estimate half-yearly revenue to have grown marginally. 1H2016 EBITDA/Gross Interest remained commendable at 5.1x while Debt-to-Total Assets ratio was maintained at ~34%. On 30 June 2016, FREIT priced a SGD60mn perpetual security with a fixed distribution rate of 5.68% p.a, proceeds will be used to reduce existing loans and releasing debt headroom for future acquisitions.

- **New acquisitions:** In 1H2016, FREIT paid SGD18mn (or 20% of total purchase price) as part payment on a new Surabaya hospital where title is expected to be issued to FREIT in 2H2021. FREIT is receiving 6% rate of return p.a from its Sponsor for effectively "pre-funding" this acquisition over the next 5 years. We view the return as acceptable, albeit on the low end vs. its cost of capital. The existing Surabaya hospital will remain operational during this time, helping to ensure continuity in rental income. In February 2016, FREIT announced a proposed joint acquisition with Lippo Malls Indonesia Retail Trust ("LMIRT") for an integrated development comprising a hospital and mall development from their Sponsor, Lippo. Due to regulatory constraints, a joint venture company ("JVCo") has been set up between FREIT and LMIRT to hold their property interest. The purchase consideration to be borne by FREIT amounts to ~SGD41m (before fees) for the hospital portion. The transaction is conditional on approval from both LMIRT and FREIT unitholders.

- **Aggressive expansion by Siloam/Lippo:** FREIT's rental income is heavily concentrated with its Sponsor, which contributes 83% to gross rental income in FY2015. Whilst rental payment to FREIT is made by Lippo, such hospitals are sub-leased to PT Siloam International Hospitals Tbk ("Siloam"), a healthcare operator ~71% owned by Lippo. With a higher proportion of hospitals still in the developmental/ramp-up phase, we expect Siloam's cash flow generation ability in the next few years to remain thin. Lippo and Siloam are also undergoing a period of aggressive expansion with 43 hospitals under various stages of development, compounding demand on capital (currently Siloam operates 24 hospitals). About 30% of Master Leases (by rental income contribution) are coming due in ~5 years, while the risk of outright non-renewal is low; the REIT is exposed to uncertainty of amendments in lease terms (eg: Lippo currently bears full currency exchange risk on base rents for the Indonesian properties where it is a Master Lessee). We expect FREIT will be further mobilised for capital recycling between the three parties.

- **PT Metropolis Propertindo Utama ("MPU") – an increasingly important counterparty:** MPU is the second largest shareholder of Lippo with ~5% stake. The company (which was last rated as non-investment grade by S&P prior to the rating being withdrawn) entered into an agreement with Siloam to expand Siloam's healthcare business. MPU also has the right to build/offer/lease out properties that will be operated as "Siloam"-branded hospitals across Indonesia. In the last two years, MPU has also become the Master Lessee on three properties bought by FREIT from MPU. We view FREIT's counterparty credit risk to be heightened following its increased exposure to MPU, but manageable for now. According to FREIT, whilst MPU is the Master Lessee, such properties are sub-leased by Siloam as the hospital operator. We maintain FREIT's issuer profile at Neutral.

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First Real Estate Investment Trust

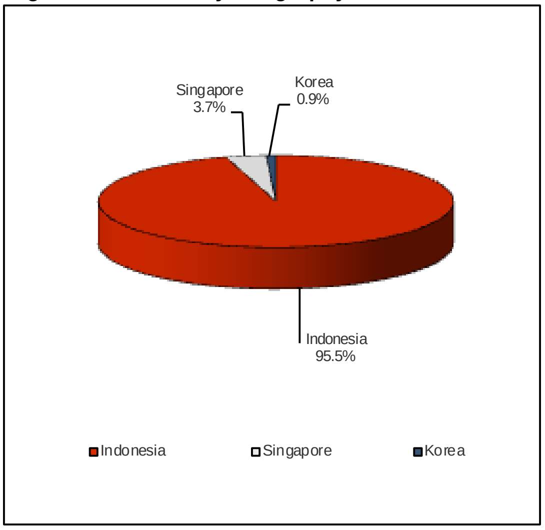
Table 1: Summary Financials

Year Ended 31st Dec	FY2014	FY2015	2Q2016
Income Statement (SGD'mn)			
Revenue	93.3	100.7	26.6
EBITDA	80.5	88.0	23.6
EBIT	80.5	88.0	23.6
Gross interest expense	15.2	16.5	4.7
Profit Before Tax	112.7	96.3	18.3
Net profit	90.6	67.8	14.1
Balance Sheet (SGD'mn)			
Cash and bank deposits	28.2	26.8	31.9
Total assets	1,212.4	1,315.2	1,327.1
Gross debt	396.6	442.6	452.4
Net debt	368.3	415.7	420.5
Shareholders' equity	745.0	791.1	792.8
Total capitalization	1,141.5	1,233.7	1,245.2
Net capitalization	1,113.3	1,206.8	1,213.3
Cash Flow (SGD'mn)			
Funds from operations (FFO)	90.6	67.8	14.1
CFO	80.8	74.3	20.2
Capex	0.0	0.0	0.0
Acquisitions	67.7	56.5	0.0
Disposals	0.0	0.0	0.0
Dividends	39.8	50.0	13.2
Free Cash Flow (FCF)	80.8	74.3	20.2
FCF Adjusted	-26.8	-32.3	6.9
Key Ratios			
EBITDA margin (%)	86.4	87.4	88.7
Net margin (%)	97.2	67.3	52.9
Gross debt to EBITDA (x)	4.9	5.0	4.8
Net debt to EBITDA (x)	4.6	4.7	4.5
Gross Debt to Equity (x)	0.53	0.56	0.57
Net Debt to Equity (x)	0.49	0.53	0.53
Gross debt/total capitalisation (%)	34.7	35.9	36.3
Net debt/net capitalisation (%)	33.1	34.4	34.7
Cash/current borrowings (x)	1.1	0.6	0.7
EBITDA/Total Interest (x)	5.3	5.3	5.0

Source: Company, OCBC estimates

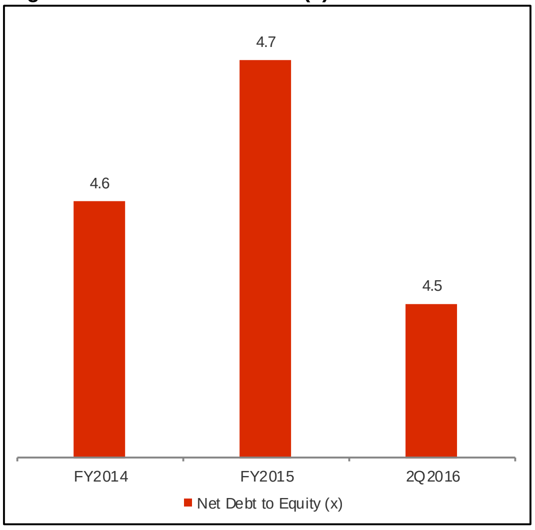
** FCF Adjusted = FCF - Acquisitions - Dividends + Disposals*

Figure 1: Revenue by Geography - FY2015



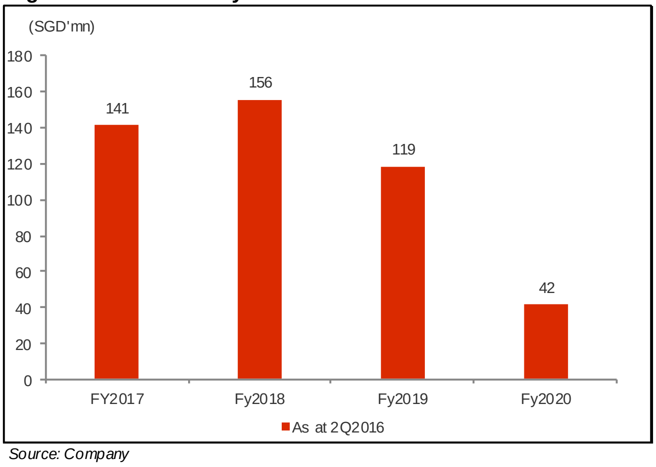
Source: Company

Figure 2: Net Debt to EBITDA (x)



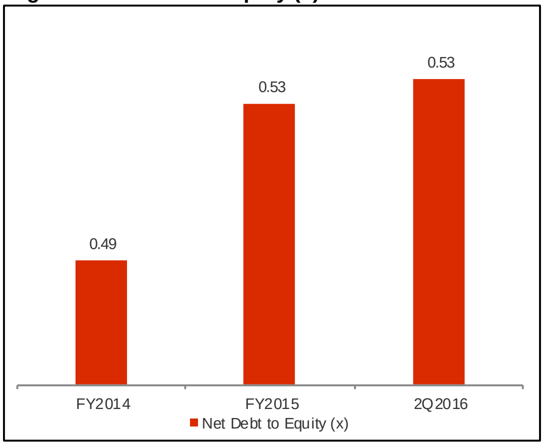
Source: Company

Figure 3: Debt Maturity Profile



Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates

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